



Surveillance and Enforcement Program: Evaluation and Recommendations

The Egypt Capital Markets Development Project



CHEMONICS INTERNATIONAL INC.



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EXECUTIVE SUMMARY

This report presents the results of an evaluation of the current state of market surveillance and enforcement in the Egyptian market and makes recommendations for improvement. The assessment and recommendations involve both the Capital Market Authority (CMA) and the Cairo and Alexandria Stock Exchanges (CASE) since both organizations presently play a role in surveillance and enforcement.

All market surveillance programs have the same basic objective: to monitor trading activity for the purpose of identifying unusual trades or patterns of trading that may indicate market manipulation, insider trading, or other fraudulent transactions. A market surveillance program cannot prevent illegal trading from taking place, but it can act as a powerful deterrent. The presence of a market surveillance program builds investor confidence in the market and sends a message that violators will be punished.

Market surveillance can be carried out by the marketplace itself, such as an exchange, by the government regulatory organization that oversees the market, or by a combination of both. How the work is shared or divided between the two organizations may depend on questions of jurisdiction, available staff, or expertise. In any case, it is not important how the work is divided between the government regulator and the exchange. What is important is the ability of the two organizations to work closely together to create an effective market surveillance program taken as a whole.

Although the overall division of workload varies from market to market, in both developed and emerging markets, immediate review of unusual trading activity is carried out by the market or the exchange. This is a logical assignment since this places the on-line monitoring function closest to the market. Because of its proximity to the market, the exchange's market surveillance staff is more likely to be aware of rumors in the market, to have immediate access to market participants to gather information, and to use its authority to intervene in the market when necessary, for example, to halt trading before news.

With this general description of the purpose and structure of a market surveillance program as background, the major findings from the assessment of the CMA and CASE market surveillance programs are as follows:

- ❑ The CMA and CASE presently operate separate market surveillance programs on an uncoordinated basis that results in duplication of effort.
- ❑ Both the CMA and the CASE market surveillance programs are adequately staffed with competent, motivated analysts.
- ❑ Both CMA and CASE market surveillance analysts require training to recognize market abuses and to conduct inquiries and investigations.
- ❑ The CMA market surveillance analysts do not have the background or legal expertise to prepare cases for disciplinary action or prosecution.
- ❑ Neither the CMA nor CASE has written procedures for conducting inquiries and investigations.
- ❑ CMA analysts continuously scan through their on-line database of the current day's trading activity to identify situations that appear unusual. This manual process is slower, less comprehensive, and error-prone in comparison to the speed and accuracy of a stock-watch system. The CMA's database, while it has the ability to highlight certain patterns of orders and trades, is not a stock-watch system.

- ❑ CASE has an on-line stock watch system that provides alerts based on the current day's trading activity but it requires significant enhancement, for example to include alerts based on historical price and volume activity.
- ❑ Both organizations have extensive databases of current and historical trading activity to use in conducting inquiries and investigations.
- ❑ A survey of surveillance software presently available through U.S. technology providers and software developers identified a very limited number of vendors, all of whom provide custom-built solutions that are too complex for a developing market such as Egypt.
- ❑ The current law limits the ability of CMA market surveillance staff to gather evidence in the course of investigations.
- ❑ The current law limits the possible remedies that the CMA can impose on market participants that violate the law, and CASE appears to have no authority to take actions against its own members. As a result, both organizations rely heavily on canceling trades as the quickest and surest method of addressing abuses.

In order to address these shortcomings and to enhance the CMA and CASE's market surveillance and enforcement capabilities to safeguard the integrity and fairness of the Egyptian market, the following major recommendations for improvement are included in this report:

- ❑ CASE should complete all three phases of development of its on-line stock watch software as quickly as possible. Once this development effort is completed, the system should be evaluated to determine whether it provides all of the functionality required to support an effective on-line market surveillance program.
- ❑ CASE should be delegated the responsibility to carry out on-line surveillance even before the exchange is formally recognized as an SRO under the Law. The CMA should rely upon CASE to do on-line surveillance and discontinue its own on-line surveillance activities following training of CASE analysts to conduct inquiries and investigations.
- ❑ The CMA should conduct off-line surveillance, relying on its well-designed database of current and historical trading activity. The CMA needs no additional software tools.
- ❑ The CMA and CASE should agree on how and when matters will be referred by CASE to the CMA for further investigation.
- ❑ Since CASE will be responsible for on-line surveillance, in order to avoid duplication of effort, before an investigation is initiated by the CMA as a result of a complaint, tip, or information from another source, the CMA should contact CASE in order to determine if the matter is already under review. In some instances, even if CASE is not already involved in a review, the CMA should ask CASE to conduct the preliminary inquiry.
- ❑ The CMA should conduct active oversight of the CASE market surveillance program in order to ensure that CASE's stock watch system identifies all unusual activity, that preliminary inquiries are opened when appropriate, that CASE follows its written procedures, that it properly documents its actions on each alert and the results of its reviews, that it follows the agreed-upon procedure for referrals to the CMA, and that the penalties levied against CASE members are appropriate.

The nature of the oversight will depend upon the confidence the CMA has in the CASE program. CASE's continuing to have responsibility for on-line surveillance should depend upon its ability to carry out its responsibilities effectively to the satisfaction of the CMA.

- ❑ A market surveillance investigation should be transferred to the CMA Legal Department when it reaches the stage where it is necessary to interview witnesses and to prepare the case for disciplinary action or prosecution.
- ❑ Market surveillance analysts at both CASE and the CMA should be fluent in English, thereby enabling them to make use of extensive English language resources and training materials on market surveillance and enforcement. As necessary, they should enroll in English classes until they can pass the English exam required for participation in international training opportunities.
- ❑ The CMA and CASE market surveillance analysts and attorneys should be trained in how to conduct reviews and investigations.

The training should be conducted in Cairo so that staff from both organizations can attend the same course. This will facilitate communication between the two groups and establish a common base of knowledge for working together.

- ❑ A detailed procedures manual should be written to cover all aspects of the on-line and off-line inquiry and investigation process as well as important administrative procedures. Both the CMA and CASE should use the same manual.
- ❑ CMA market surveillance analysts should be given the ability and the authority to contact and question brokers, customers, and listed companies in connection with an investigation without first obtaining permission from their supervisor.
- ❑ Enforcement actions resulting from the market surveillance program should be publicized as widely as possible to maximize their deterrent effect.

Although difficult to achieve, the following changes in the Law and regulations would further strengthen the market surveillance and enforcement program:

- ❑ The CMA should seek explicit authority under Article 49 of the Law to delegate to market surveillance personnel conducting investigations the authority to obtain documents from any person believed to have information about possible violations of securities laws, regulations, or rules.
- ❑ The CMA should require companies licensed under the Law to keep records and make them available to market surveillance and other CMA staff upon request.
- ❑ Article 30 of the Law should be amended to provide for penalties to be assessed for the violation that led to the action. Penalties could include fines or other disciplinary measures.
- ❑ Article 31 of the Law should be amended to provide for a broader list of penalties such as fines or other sanctions.
- ❑ The authority of CASE to take action against its members should be clarified.
- ❑ The CMA should be empowered to take administrative action against and impose sanctions on individuals who work for, control, or are otherwise associated with companies licensed by the CMA.

In conclusion, there are many ways to strengthen the market surveillance and enforcement program at the CMA and CASE. The four most critical short term steps include: (1) close coordination between the two organizations, with CASE taking responsibility for on-line inquiries and investigations involving its members and the CMA taking responsibility for off-line investigations and prosecution; (2) enhancement of the on-line stock watch system at CASE; (3) development of and reliance upon written procedures by both organizations; and, (4) thorough joint training of all staff in how to conduct inquiries and investigations.

In the long term, both organizations must have greater powers to enforce the Law and the regulations and more remedies for correcting abuses. By working closely together under the structure recommended in this report, CMA and CASE will create an overall effective market surveillance and enforcement program to protect all investors in the Egyptian market.

Assessment and Recommendations

The results of the assessment of the Market Surveillance and Enforcement program at the Capital Market Authority (CMA) and the recommendations for change are covered in nine sections, specifically, organization/structure, staffing, resources, training, procedures and checklists, automation, technology, enforcement, and legal and regulatory structure. As background to the assessment and to provide a framework for the resulting recommendations, the first section entitled “Overview of a Market Surveillance Program” describes the purpose and structure of a generic market surveillance program.

MARKET SURVEILLANCE AND ENFORCEMENT PROGRAM

A. Overview of a Market Surveillance Program

□ Purpose

A market surveillance program monitors trading activity for the purpose of identifying unusual trades or patterns of trading that may indicate market manipulation, insider trading, or other fraudulent transactions. Instances of unusual activity that are identified are followed-up by specially trained analysts and investigators and, where warranted, prosecutions or disciplinary actions.

Although market surveillance cannot prevent illegal trading from taking place, it can act as a powerful deterrent. When someone trades on inside information, is investigated by market surveillance, and is severely disciplined, others refrain from trading on inside information because of the risk of getting caught. The very presence of a market surveillance program adds credibility to the market. It sends a message to investors that the market is fair and that those who violate the rules will be punished.

□ Role of the Government Regulator

The market surveillance program can be carried out by the marketplace itself, such as an exchange, by the government regulatory organization that oversees the market, or by a combination of both. How the work is shared or divided between the two organizations may depend on questions of jurisdiction. For example, the U.S. Securities and Exchange Commission (SEC) investigates all matters that involve public individuals who are not registered securities professionals or public companies because securities exchanges have no jurisdiction over such persons and entities. On the other hand, the SEC relies on the U.S. exchanges to pursue all other matters that involve securities professionals because they do have jurisdiction. Even though it delegates responsibility for market surveillance to the exchanges, the SEC exercises oversight over the exchanges' activities.

How far the exchange pursues an investigation before referring it for further investigation or prosecution by the government regulator varies from country to country sometimes based on jurisdictional issues and other times based on practice or available staff or expertise. In any case, it is not important how the work is divided between the government regulator and the exchange. What is important is the ability of the two organizations to work closely together to create an effective market surveillance program taken as a whole.

Although the overall division of workload varies from market to market, in both developed and emerging markets, immediate review of unusual trading activity is carried out by the market or exchange. This is a logical assignment since this places the on-line monitoring function closest to the market. Because of its proximity to the market, the exchange's market surveillance staff is more likely to be aware of rumors in the market, to have immediate access to market participants to gather information, and to use its authority to intervene in the market when necessary, for example, to halt trading before news.

□ The Investigative Process

A market surveillance program is usually composed of both a real-time ("on-line") and an in-depth ("off-line") staff. The on-line staff is responsible for reviewing unusual or possibly suspicious trading activity as soon as it occurs. On-line market surveillance analysts rely upon computer software to bring to their attention any market activity that is abnormal. When they are alerted to unusual activity, they conduct an immediate review to determine quickly whether there is a reasonable explanation for the activity. For example, there may be news which has

caused the price of a stock to rise dramatically. If, on the other hand, there is no ready explanation for the activity, it will be reviewed further to determine whether there is evidence of rule violations. On-line analysts focus on reviewing trading activity which takes place during the current trading day. Any matter which is still open and requires further review by the end of the trading day is generally referred to analysts who conduct “off-line” or more in-depth reviews.

Off-line analysts do in-depth reviews of matters initiated by the on-line analysts and preliminary reviews of unusual trading activity that takes place over more than a single trading day, for example, a week, a month, or several months. The off-line staff are alerted to unusual activity by a software program that tracks historical trading activity. The off-line staff is not under the same time constraints as the on-line staff and thus can conduct as thorough a review as is necessary in order to reach a determination whether to continue or to terminate a review. When the activity in question can be explained as being normal or not in violation of any rules, the matter is closed. If there is evidence of rule violations, the review becomes a formal investigation. The primary differences between a review and an investigation are the depth of the analysis, the time expended, and the comprehensive nature of the analysis. Many of the same analytical tools are used in both reviews and investigations.

Once an investigation that clearly involves violations is ready to be prepared for prosecution it is taken over by a staff attorney who understands the rules and the underlying law, is trained in taking testimony, and has the necessary expertise to prosecute the case. Once the case has been fully documented and the legal issues summarized, the attorney presents it to the judicial body that is ultimately responsible for determining whether the case involves rule violations and what penalty should be assessed.

Not all market surveillance programs operate in this fashion. In some situations the staff person investigates a matter from the time it is initially uncovered until it is closed or prosecuted. How the workload is divided among the staff is not important. What is important is that all staff are efficiently deployed and that each has the expertise necessary to carry out the function he/she is assigned. Because the on-line function requires dedicated resources and the number of matters that may arise at any one time is unpredictable, most market surveillance programs isolate the on-line staff from conducting anything but real-time reviews. Most matters uncovered on-line but not concluded by the close of the trading day are ordinarily handed off for further review by other market surveillance staff simply to enable the on-line staff to focus their attention on the matters that arise the following trading day.

□ Prioritization of Reviews and Investigations

The sheer volume of trading in most markets requires that market surveillance staff be selective about which stocks and/or individual transactions they review. No market surveillance program is sufficiently staffed to review all transactions no matter how small the market. How stocks or transactions are selected for review is critical. From any given day’s trading activity only a handful of situations can be selected for initial review.

Since there is never sufficient staff to investigate all unusual market activity that is brought to the attention of market surveillance, only the most egregious matters are investigated. At all stages of an investigation, it is weighed against all other investigations being pursued and only the best investigations are continued. Only cases with clear proof of wrongdoing are prosecuted. All others are closed.

This prioritization process which results in only the strongest investigations being pursued and all others being closed is consistent with the purpose of market surveillance. Market surveillance programs do not prevent illegal trading activity. They also do not detect every

abuse that occurs. But most importantly, a market surveillance program cannot investigate every instance of unusual market activity that it uncovers. It would take many more staff than is feasible to pursue every possible market abuse, even in the most highly developed markets. Thus, the objective of a market surveillance program is to develop cases which lead to penalties for the most egregious and visible market abuses, relying on wide publicity of the penalties to deter others from acting similarly and damaging the market.

❑ Detection Sources

Computer programs are probably the most effective tool used by market surveillance for detecting situations requiring review. Each security has its own characteristic trading patterns, including price volatility and volume. Based on past performance, the range of price and volume change in a stock is predictable. When trading in the stock breaks this pattern, computers can alert market surveillance to conduct a follow-up analysis.

Computer programs that generate such alerts are known as stock-watch systems. They take into consideration each security's historical trading pattern, including buyers and sellers and their individual characteristics, and, by comparing these historical patterns to current trading, they can identify when activity in a security is unusual or outside the norm. Once the system flags a situation as being unusual, the market surveillance staff conducts a preliminary review to determine whether the situation requires further review.

At any point in time, particularly during times of significant market turmoil, the stock-watch system may flag more situations than can possibly be reviewed by the available staff. As a result, even though trading in a stock may be flagged as unusual, it may not be selected for review if there are other stocks with even more unusual trading patterns. At any point in time, only the most egregious matters can be selected for review.

Situations requiring review may also be brought to the attention of market surveillance through tips, both by market participants and by members of the public. Customer complaints can also serve to notify market surveillance of activity in a stock that on its surface does not appear to be unusual but which should be reviewed. And finally, news sources can be an effective means of identifying matters requiring review. All of these sources for detecting unusual market activity – computer programs, tips, customer complaints, and news – are essential to the function of an effective market surveillance program.

❑ Staffing

In order to develop cases that lead to penalties, the market surveillance program must be staffed with competent, well-trained professionals to follow-up the leads that are generated by the stock watch system or other sources. The staff must be able to conduct a thorough investigation, take testimony from witnesses, document findings, and detail the violations of the regulations and underlying law sufficient to support disciplinary action. From the time a matter is initially detected and reviewed, it may involve the skills of an analyst, an investigator and an attorney before it is successfully prosecuted.

B. Organization/Structure

□ Assessment

Both CMA and CASE have established market surveillance programs and they operate independently with little or no contact between them. In fact, until recently, the supervisors of the respective programs had not met. The single point of contact between the two organizations appears to be the chairmen.

Each organization uses different software for monitoring the market and conducts inquiries and investigations independent of the other. There have been occasions when both organizations have made simultaneous requests for the same information from brokers in a particular stock. This lack of coordination and duplication of effort is accepted by both organizations as inevitable. There appears to be little concern about the impact on the brokerage community of regulatory duplication.

Both organizations acknowledge that CASE should have primary responsibility for “on-line” surveillance. However, assumption of this responsibility appears to be tied to CASE’s designation as a self-regulatory organization (SRO) which is not allowed under the current Capital Market Law.

CASE management understands the purpose of a market surveillance program and has created an environment and hired a staff that is capable of carrying out the function responsibly. The staff need additional training in on-line and off-line reviews and investigations and the stock-watch system and database need to be further developed. Despite these drawbacks, CASE is able to assume responsibility for on-line surveillance of CASE-listed securities at the present time. A full assessment of the CASE Market Surveillance program is covered in Appendix C.

□ Recommendations

1. CASE should be delegated the responsibility to carry out on-line surveillance following training of its analysts in conducting on-line reviews and investigations. Delaying the assignment of this responsibility until CASE is formally designated an SRO is unnecessary. Market surveillance is a shared responsibility between the exchange and the government regulator in all markets, whether or not the exchange is an SRO. At present, CASE has authority under the law to take certain disciplinary actions and is not precluded from performing on-line surveillance. CMA should rely upon them to do so and discontinue their own on-line surveillance activities.
2. CMA and CASE should jointly determine how and when matters will be referred by CASE to CMA for further investigation. Preliminary inquiries that are still open at the end of the trading day could be completed by CASE or referred to CMA. The guiding principal as to which of these two alternatives is appropriate depends upon the nature of the particular inquiry.

If the matter concerns a few transactions, can be completed promptly, or appears to involve individuals or firms over which CASE has jurisdiction, the matter should be pursued further by CASE. If, on the other hand, the matter concerns a longer period of time, is complex, high profile (having been discussed in the press), is particularly egregious, or involves individuals or companies outside of CASE jurisdiction, it should be referred to CMA for further investigation.

In some cases, it will be appropriate for both CASE and CMA analysts to work jointly on an investigation, particularly in those instances where both organizations have some jurisdiction. In order to ensure that the work of both organizations is tightly coordinated

during a joint investigation, it is recommended that the CASE analyst temporarily carry out his or her activities in the same office as the CMA analyst.

CASE and CMA staff should have the same procedures and should be trained jointly in surveillance and investigation techniques. While CMA will not be conducting on-line surveillance, they need to understand what is entailed. In terms of pursuing investigations, joint training will greatly enhance the analysts' ability to work together. CMA should actively conduct oversight of the CASE market surveillance program.

The purpose of oversight is to ascertain that CASE's stock watch system is effective in identifying unusual market activity, that CASE appropriately selects alerts for review, that it follows its written procedures, that it properly documents its reviews and investigations, that it follows the agreed-upon procedure for referrals to CMA, and that the penalties it levies against members are appropriate.

CMA oversight of CASE can take many forms, including formal on-site inspections during which all aspects of the market surveillance program would be reviewed. Oversight is also exercised through other means such as periodic reporting requirements. The CMA could, for example, require CASE to notify it promptly whenever it selects a stock for review. It could also require CASE to summarize its inquiries and investigations on a regular basis, perhaps weekly.

The amount of routine oversight the CMA exercises through reporting requirements, as well as through formal on-site inspections, will vary from time to time depending upon their confidence in CASE's surveillance program. As CMA's confidence grows, oversight can be reduced, recognizing that if questions of performance arise at any time, for example in connection with a particular investigation, CMA can initiate an immediate oversight inspection.

CASE's continuing to have responsibility for on-line surveillance should depend upon its ability to carry out surveillance effectively to the satisfaction of the CMA.

C. Staffing

□ Assessment

The CMA Capital Market Surveillance Department is presently staffed by three market surveillance analysts and two IT programmers who maintain and enhance the surveillance software which the staff uses to monitor transactions and review historical market activity. (There is one opening for a market surveillance analyst that was created by a recent death). The three analysts conduct most of the reviews and investigations but are assisted part time by one of the IT programmers.

Two attorneys presently reside in the market surveillance area. They process all customer complaints and assist the analysts with legal issues that arise in the course of investigations.

In terms of additional areas of expertise, one of the analysts has passed Level One of the CFA exam and is studying for Level Two and another is experienced at reading and analyzing corporate financial statements. One of the IT programmers has passed Level Two of the CFA exam and is proceeding on to Level Three.

One of the analysts speaks and understands English quite well and one programmer understands English. The others are less fluent in English.

❑ Recommendations

1. Assuming that CASE is responsible for on-line surveillance, the present three analysts (or four, if the opening is filled) are sufficient to conduct off-line reviews and investigations.
2. Once an investigation has developed to the point where it is necessary to interview witnesses, it should be referred to the Legal Department to complete the investigation and to prepare the documentation required for disciplinary action or prosecution.
3. The two IT programmers should continue to support the further development of the market surveillance database and the design of new tools for investigations.
4. Ideally, analysts should have excellent written and verbal communication skills and fluency in both Arabic and English, thereby enabling them to make use of extensive English language resources and training materials on market surveillance and enforcement. They should also hold a degree in business, accounting, or finance.
5. CMA and CASE analysts should not be expected to participate in routine inspections of broker/dealers. Broker/dealer examiners or inspection teams from both organizations should be trained to gather evidence to support market surveillance investigations.

D. Resources

❑ Assessment

The CMA Market Surveillance Department is expected to move into new space being renovated by the CMD project in the very near future. This new space will address several important needs, in particular, to isolate the program so that the confidentiality of the analysts' work is maintained. Additionally, the electrical and telephone systems will be upgraded in conjunction with the renovation of the new space to support more modern equipment.

The analysts are hampered in carrying out their work by a lack of up-to-date personal computers (PCs). Over half of their PCs are either inoperable or incapable of accessing the historical information in the market surveillance database. The CMD project purchased a total of 30 PCs for the CMA, 7 of which were designated for market surveillance. However, only two of these PCs were given to market surveillance, specifically for the IT programmers.

The analysts are further hampered by the lack of outside phone lines to contact brokers and issuer companies and to coordinate with CASE during investigations. They do not have access to the Internet or to an international newswire like Reuters. Both of these resources are needed to monitor news in CASE-listed companies and the Egyptian market in general. Finally, they do not have a FAX for receiving information requested from brokers and issuers. On the positive side, they have two printers networked to their PCs which enables them to print information from the surveillance database.

The market surveillance staff relies almost exclusively on writing summaries and investigative reports in long hand. While they have Microsoft Word on their PCs, they are not sufficiently familiar with the program to use it. Their hand-written documents are reviewed by their supervisor and subsequently typed by a secretary.

Analysts have access to information on customer complaints because all such complaints are handled by the two attorneys who share their space. This is advantageous because customer complaints are an important source of leads on possible market impropriety and may also provide collaborative evidence for investigations.

Analysts also have access to filings by listed companies. These filings are a critical investigative resource as they include the company's financials, the names of its officers and directors and large shareholders, and information on significant contracts and pending agreements.

□ Recommendations

1. Each analyst should have a full feature telephone (hold button, voice mail, call transfer) with access outside the CMA. Consideration should also be given to providing Market Surveillance with access to the "Hotline" which links all broker/dealers.
2. Establish a market surveillance library for manuals, training materials, newspapers and periodicals, memoranda, and other documents such as case reports, for reference and training purposes.
3. Analysts should have Reuters or another market data vendor for researching news on specific companies and market data on worldwide markets and the Egyptian market in particular.
4. Market Surveillance should also have subscriptions to periodicals and industry publications such as business and banking journals so that analysts can stay informed of events that might be contributing to increased price and/or volume activity in a particular security, a particular industry, or the overall market.
5. There should be a FAX machine in Market Surveillance for receiving information requested from brokers and/or listed companies pertinent to an investigation.
6. Analysts should have access to the Internet for researching news and other information in connection with investigations. In the future, analysts will need to learn how to monitor the Internet for indications of manipulative activities affecting stocks listed on CASE.
7. Continue to provide analysts with access to information on customer complaints and to listed company filings.
8. Provide analysts with nearby, convenient access to a photocopier so that "working copies" of original documents can be made for use during investigations. Provide convenient access to a shredder for use during the course of investigations.

E. Training

□ Assessment

The analysts were given one-on-one training in monitoring and investigative techniques by a former CMD project advisor.

Since this training was informal and targeted to the individual needs of each staff member, it is impossible to document what was covered in these sessions.

Between September 1998 and October 2000, none of the analysts attended either the U.S. SEC International Institute for Securities Market Development that is held in April of each year or the U.S. SEC International Training Institute for Securities Enforcement and Oversight that is held in November of each year. Apparently, the supervisor of Market Surveillance attended the April Institute in 1996 and the IT programmer who does some market monitoring attended the same Institute in 1997.

□ Recommendations

1. CMA and CASE analysts should be given basic training in conducting on-line and off-line reviews and investigations. This training should cover what fraudulent activity to look for (e.g. manipulation, insider trading, etc.), how to find it and investigate it, how to prove it, and how to document findings. Attorneys at CASE and in the Legal Department at CMA who will be preparing market surveillance cases for disciplinary action and prosecution may also want to attend this training.

The training should be conducted in Cairo for several reasons. It would enable all CMA and CASE analysts to attend the same course, thereby facilitating communication between the two groups and establish a common base of knowledge for working together. In addition to the fact that a Cairo-based training is much more cost-effective than individualized overseas training, knowledge of what has been covered in the course will enable CASE and CMA supervisors to incorporate the training materials into the procedures manual and to hold the analysts accountable for benefiting from the training. Since the trainers are likely to be English-speaking market surveillance experts, and not all participants will be fluent in English, some arrangement should be made to assist these participants in understanding the material covered during the training.

A sample agenda for a basic market surveillance training course is included in Appendix F. This formal classroom-training program should be followed-up within a few weeks by hands-on, one-on-one support to each analyst. Working directly with each analyst, the trainer will review investigations conducted by the analyst since the classroom training to ascertain whether the analyst is following the approach outlined in the training and to provide assistance and further guidance where needed. This kind of reinforcing follow-up support by the trainer will enhance the learning of each participant and will help identify where additional formal training may be needed.

3. Since the CMA will conduct oversight of CASE's on-line surveillance activities, the CMA staff responsible for oversight inspections should attend the training as well.
4. CMA and CASE staff that conduct on-site inspections of broker/dealers should be trained to gather evidence to support market surveillance investigations.
5. The CMD-planned training "Surveillance Practices in Stock Exchanges" should be expanded to include as many of the CMA and CASE analysts as is feasible. In order to ensure that analysts who do not attend this training get some benefit from their colleagues' attendance, attendees should be required upon their return to Cairo to provide a workshop on what they learned. All materials handed out during the training should be incorporated into the procedures manual and made available to all analysts for reference purposes. In addition to fluency in English, equally important criteria for selection of candidates for such overseas training should be a willingness to share what they have learned with their colleagues.
6. Analysts should attend one or both of the U.S. SEC Institutes in order to expand their understanding of effective surveillance and enforcement. As noted earlier, attendees to any U.S. SEC Institute should be required to provide a workshop in Cairo for their colleagues upon their return. In addition, all training materials received during the Institutes should become an active part of the procedures manual and reference manual.
7. English is the universal language of the global financial markets. While the ability to speak, read, and understand English isn't important in the day to day function of a CMA analyst, it is critical if he/she is to take advantage of training opportunities at exchanges and financial

institutions throughout the world and to stay current in international developments in enforcement by reading documents, such as those published by the International Organization of Securities Commissions (IOSCO).

All analysts currently assigned to Market Surveillance should attend classes in English until they are sufficiently fluent to pass the English exam required for participation in international training opportunities.

8. Analysts should be trained in Microsoft Word and encouraged to compose their investigation reports on their PCs.

F. Procedures and Checklists

□ Assessment

The analysts have no written procedures or checklists upon which to rely in monitoring the market, conducting preliminary inquiries, or pursuing formal investigations. As a result, there is no way to ensure that unusual market activity is properly reviewed or that reviews are conducted in an efficient and consistent manner. Moreover, they appear to have no written resources other than the Capital Market Law for reference during the course of an investigation.

Each analyst works independently and establishes his or her own approach to monitoring the sector(s) of the market he/she has been assigned. Each makes determinations about what constitutes unusual market activity and carries out investigations utilizing his or her own level of experience and expertise. Depending upon how many situations arise in an analyst's sector, he/she may be overloaded while another analyst is relatively free.

Analysts are responsible for investigating unusual market activity that arises in their sectors from the moment it is discovered until the matter is closed or forwarded to the CMA Chairman. They are responsible for conducting the investigation, gathering and documenting evidence, interviewing witnesses, and writing legal memoranda.

Each analyst scans the CASE message board for announcements of interest and reads the daily newspapers that carry financial news before the market opens for articles that may have an impact on the market generally or on particular stocks in his/her sector.

The customer account number as well as the identity of the broker/dealer is carried in the database for each order and each transaction. Once an inquiry is initiated, the analyst must request the names of customers from their supervisor.

□ Recommendations

1. Analysts should be given the ability and the authority to contact and question brokers, customers, and listed companies in connection with an investigation without first obtaining permission from their supervisor.
2. Until CASE assumes full responsibility for on-line reviews, CMA analysts should be divided between on-line and off-line so that resources are always dedicated to real-time monitoring of the market.
3. In the initial stages of most routine investigations, documents such as copies of orders or customer account forms should be requested and obtained from brokers by FAX or hand delivery as opposed to on-site visits to firms' offices.
4. Daily responsibility for reading the newspaper and scanning Reuters for pertinent news should be assigned to one analyst who would summarize the information for the other analysts.

5. Investigations should be assigned to analysts by the supervisor according to open case workload rather than some other criteria such as market sector. Since cases require differing levels of effort, analysts should have different numbers of open cases.
6. Since CASE will be responsible for on-line surveillance, in order to avoid duplication of effort, before the CMA initiates an investigation as a result of a complaint, tip, or information received from another source, CMA should contact CASE in order to determine if the matter is already under review by them. In some instances, even if CASE is not already involved in a review, CMA should ask CASE to conduct the inquiry.
5. Consideration should be given to providing analysts with secure access to customer names. At present, analysts must request the name of the customer associated with a particular account number from their supervisor. This procedure delays the investigation. Requests for customer names could be password secure and an audit trail of all requests for such information should be created to provide additional protection.
6. Develop a procedure for transferring an investigation from the analyst to an attorney in the Legal Department once the investigation reaches the point where it is necessary to interview witnesses. The attorney would be responsible for conducting the investigation from that point forward, documenting the findings, and preparing the matter for disciplinary action or prosecution.
7. Develop a process for tracking the current status and final disposition of all investigations from the time they are opened (or referred from CASE) until they are closed or referred to the legal department. This tracking system can be used by the market surveillance supervisor to assess the performance of analysts and to monitor the overall effectiveness of the surveillance function.
8. CASE should develop a similar audit trail of actions taken on each alert generated by the on-line stock-watch system. When the CMA conducts an oversight exam of the CASE program, it should be able to easily determine whether an alert was selected for review, and if not why it was not selected. Further, the audit trail should document the actions taken on all alerts selected for review from the time the review commences until it is closed, disciplinary action is taken, or the matter is referred to the CMA.
9. A detailed procedures manual should be written to cover all aspects of the on-line and off-line investigation process and should be used by both the CMA and CASE. The manual should include administrative procedures for assignment of cases and for tracking actions taken on reviews and investigations. Procedures to be followed by CASE in reporting to the CMA and those to be followed by the CMA in conducting oversight exams should also be included in the manual.
10. A manual of reference materials should be assembled to complement the procedures manual and provide additional support to investigations. An annotated Table of Contents for an initial Investigation Reference Manual is included in Appendix D.

G. Automation

□ Assessment

As noted in the Introduction above, on-line monitoring of both daily and long-term market activity is a critical feature of any market surveillance program. Automated databases of historical order and transaction information, issuer financial information, broker/dealer and customer information, and news are also helpful to the investigatory process.

CMA analysts rely heavily on a database of information on the current trading day's open orders and transactions to identify unusual activity. (Occasionally an outside tip or customer complaint causes a review to be initiated as well.) The database can be flexibly and easily manipulated to provide a full profile of the current day's trading activity in a particular stock, by a particular broker in all or selected stocks, or by an individual customer, or a combination of these factors. In addition, the database includes historical transaction information going back to 1996. Graphing capability enables analysts to quickly determine what period of time is of greatest interest in a stock.

The database highlights certain orders or transactions of concern to the analysts such as orders that cross the market or transactions by a principal of a broker. The analyst can request a view of all orders or trades that are higher or lower than the previous close by a defined percentage, can ask to see a listing of multiple identical orders by the same customer, and can review the three top stocks by value of orders, volume, or some other criteria. These are just a few of the ways that the database can be re-sorted to analyze current as well as historical activity.

The database appears to contain all of the information relevant to researching the current and historical trading in a stock with the exception of the fact that once an order is executed it no longer appears in the database. A complete audit trail of order information prior to its execution or cancellation is retained in the Information Technology Department but is not easily accessed by the analysts. Furthermore, it appears that the order data is not retained more than a week or so after trade date.

The CMA database is not a stock-watch system as described in the "Overview of a Market Surveillance Program" in the beginning of this Section. A database is an essential research tool once a stock has been selected for review. Because the CMA does not have a stock-watch system which selects stocks for review, the analysts must continuously scan through the database looking for situations that appear unusual. Basically, they perform on a random basis the analytic review that stock-watch software could do instantaneously.

This manual process is much less effective than a software program for several reasons. It is slower and less comprehensive. It is prone to error and subject to analysts' differences of opinion as to what constitutes unusual activity. And it doesn't take into consideration historical trading patterns or measure unusual activity that takes place over a week, a month, or longer. And it requires all analysts to be constantly at their desks reviewing the market in order not to miss anything unusual. Of course, this is unrealistic since the same analysts that are monitoring the market must also investigate any unusual activity they uncover.

A former CMD advisor designed a stock-watch system for flagging unusual trading activity for CMA. The program used historical trading activity to determine the average trading range for each stock on a weekly, monthly, and annual basis. This information created a record of a "normal" trading pattern for each stock. The daily trading activity in each stock was then compared to the "normal" pattern using a series of adjustable parameters. Current trading data was measured in three ways: 1) the average variation between trades, 2) the average trade size, and 3) the average deviation from VWAP.

The system was designed and implemented in 1999 by CMA. Its initial implementation generated too many alerts and the analysts did not have sufficient time to review all of them to determine which were “legitimate.” As a result, they concluded that a stock-watch system was unworkable and useless and they abandoned it. Although the parameters could have been adjusted to reduce the number of alerts, the analysts were unwilling to invest the time necessary to make the adjustments stock by stock.

This unfortunate experience caused the CMA staff to develop a negative view of one of the most important tools available to an effective market surveillance program. Without the assistance of such a system, the analysts can’t ensure that the most egregious market problems are uncovered and investigated.

The CMA staff’s rejection of this particular stock-watch system was not without justification. The measures selected to generate alerts were much too micro. They measured the variations in the price and size of individual transactions as opposed to looking at price and volume across all activity in a stock. More macro measures would have been sufficient to alert the staff to situations requiring review. The detailed trade-by-trade analysis in the “rejected” stock-watch system illustrates the kind of detailed analysis that is ordinarily conducted once activity in a stock has been determined to be unusual and an investigation is initiated.

□ Recommendations

1. Because CASE will be responsible for on-line surveillance, the well-designed database used by CMA analysts today will be a sufficient resource for off-line investigations. There is no need for CMA to implement its own on-line stock-watch system.
2. Retain information in the CMA database on all orders, from the time they are entered until they are modified, cancelled, or filled. This information should be retained in the database and be accessible to analysts for the same length of time as information on trades is maintained.
3. Continue to have two IT programmers dedicated to market surveillance so that enhancements to the market surveillance database can be made without interfering with other CMA IT priorities.

H. Technology

□ Assessment

In conjunction with conducting an assessment of the Market Surveillance program at the CMA and CASE, a survey was conducted of surveillance software presently available through U.S. technology providers and software developers, as well as those in use in international markets.

This survey revealed that there are a very limited number of software developers or technology providers of surveillance systems. Most of the software presently available is custom-built and relatively complex. None of the U.S. providers have created a cost-effective stock-watch system that would be appropriate for an emerging market like Egypt.

Five software developers worldwide were identified as having some capability of deploying a market surveillance system. (One additional software provider failed to provide information.) Summarized below is information gathered from the five companies on their surveillance capabilities. More detailed information on each company and its product, including marketing brochures where available, is included in the addendum to this report.

- *Computershare, Ltd.*

Headquartered in Sydney, Australia, Computershare has installed its SMARTS surveillance system at the Jakarta Stock Exchange, the Hong Kong Stock Exchange, Securities and Futures Exchange in Hong Kong, and the Oslo Stock Exchange.

SMARTS is composed of 12 modules which can be installed in one of four, increasingly sophisticated levels. Level 1 provides the most elementary system but has no “alerts” capability. Level 2 adds alerts and at Level 4 all the capabilities of the system are available. All current SMARTS clients have a Level 2 system or higher.

The ability to install the SMARTS system in increasingly sophisticated configurations makes it flexible and appealing to a smaller market. No information is available on the cost of installing SMARTS or how clients view its effectiveness.

- *EFA Software Services Ltd.*

Headquartered in Calgary, Alberta, EFA has developed MICA which is an historical investigative tool for market manipulation cases. It identifies which purchaser bought shares from a particular seller by comparing back-office records with trade records. The use of the automated matching process greatly shortens the time needed to complete the investigation. The MICA system has been implemented recently at some of the Canadian Exchanges and at the Royal Canadian Mounted Police which is the government securities regulator.

MICA is so new that very little information is available about it, including costs of installation. In any case, MICA is not a stock-watch system but rather a tool for conducting a single type of investigation—market manipulation.

- *Plural, Inc. (Former Name: Micro Modeling Associates)*

Plural, formerly known as Micro Modeling Associates, participated on a team with Unisys Corporation and Microsoft to develop the Surveillance Delivery Real-Time (SDR) system for NASDAQ. This system replaced NASDAQ’s existing on-line alert system, provided additional alerts, integrated historical and transaction data into the alert system, and provided NASDAQ with an easy means of redesigning the alerts whenever necessary.

Plural does not presently have a stock-watch system like SDR to market to other exchanges. It uses the experience it gained from designing the NASDAQ system to build custom surveillance software systems for clients.

Plural builds complex stock-watch systems from the ground up for large markets that have extensive volumes of market data to process. Plural’s solution would be expensive and more sophisticated than needed in an emerging market.

- *Searchspace Corporation*

Searchspace, which is headquartered in London, England, has provided market surveillance systems for the London Stock Exchange, the New York Stock Exchange, and the Archipelago/Pacific Stock Exchange. The company has developed the Intelligent Transaction Monitor (ITM) which connects to databases, processing systems, and external data sources to create historical profiles for all entities including individual stocks, brokers, and traders. By using ITM, the surveillance system provides context-sensitive monitoring of all market activity looking for unusual activity whether defined by “hard” rules, context-sensitive criteria or by patterns of behavior. Specific patterns of behavior such as insider trading, front running, wash trades, manipulation, and market risk can be monitored by the system’s components which can be deployed individually or as a complete package.

Searchspace appears to have the most sophisticated surveillance package presently available. The system is designed to allow for any one or more components to be plugged into the basic

framework. In addition to professional services – which could be extensive – to configure the software to the client’s systems, the licensing fees for the software run from \$300,000 to \$1,000,000 a year with a minimum three-year contract.

The new Archipelago Stock Exchange just recently selected Searchspace from among some of the other vendors mentioned here to build their market surveillance system. Although Searchspace has a modularized solution which can be installed in a complex or simple configuration, its annual licensing costs, not including one-time installation costs, make it cost prohibitive for an emerging market.

▪ *SRA International, Inc.*

SRA, headquartered in Fairfax, Virginia, designed a surveillance system for NASDAQ called Mantas. The Mantas system uses special tools, known as knowledge discovery tools, to find patterns and relationships embedded in very large amounts of data from multiple sources. NASDAQ selected SRA to build its surveillance system because of their ability to manage unusually large amounts of data.

In addition to detecting prohibited activities like front running and insider trading, Mantas sifts through data to look for previously unknown or emerging patterns of activity that raise concerns. SRA believes that their sophisticated algorithms augment the standard alerts in most surveillance systems and provide insights into the behavior that caused the alert.

Before SRA can estimate the cost of customizing Mantas for a client, it conducts a feasibility study to develop the functional and technical requirements and builds a prototype to demonstrate how the system would be applied. The cost of these consulting services and the development of a production system would depend upon the complexity of the market in which the system is to be installed.

Using Mantas as the base, SRA provides custom-designed solutions. Their system is complex and, like the Searchspace software, is well-suited to sophisticated markets with extensive market data processing requirements.

□ Recommendations

1. Because CASE will be responsible for conducting on-line surveillance, there is no need for CMA to install their own on-line stock-watch system. The database system they have implemented will provide sufficient support to off-line investigations.
2. CASE employed two Oracle software developers to design a stock-watch system to be implemented in three phases. The first phase of the system is partially installed and is being used by CASE market surveillance analysts. The system as described by CASE, when fully implemented, appears to have all of the functionality necessary for an effective on-line market surveillance program. All three phases of development of the software should be implemented on a priority basis.
3. Once the CASE on-line stock watch system has been fully implemented, CMA should evaluate the system to determine whether it provides all of the functionality required to support an effective on-line market surveillance program.
4. Given the fact that a stock-watch system has already been custom-designed for CASE and is presently being implemented, there appears to be no need to purchase additional surveillance software for the Egyptian market at the present time.

I. Enforcement

□ Assessment

An effective enforcement program requires a well-trained staff, primarily composed of attorneys with the requisite skills to take testimony of witnesses and to draft legal memoranda for prosecution. At the present time, all market surveillance matters that are referred for disciplinary action are carried from the point of initial discovery, through the investigation, and, finally, to the preparation of the memorandum recommending disciplinary action by the same analyst, even though he or she may not have the necessary legal expertise.

Under the present Law, only the CMA staff named in a decree by the Ministry of Justice have the power to examine documents and, presumably, interview witnesses in the course of an investigation. This requirement places a significant limitation on the ability of market surveillance analysts to develop evidence in the course of investigations.

An enforcement program is also aided by broad dissemination of disciplinary actions as a deterrent to wrongdoing. At present, not all enforcement actions are disclosed.

If there were a more concerted effort to improve understanding of the Law and regulations by individuals, market participants, and public companies it might eliminate inadvertent violations might be reduced thereby enabling CASE and CMA to focus their surveillance and enforcement efforts on more serious offenders.

❑ Recommendations

1. As noted earlier under Staffing, a market surveillance investigation that involves potential rule violations and has reached the stage where witnesses need to be interviewed should be turned over to an attorney in the Legal Department who understands the law and can prepare the case for disciplinary action or prosecution.
2. The CMA should seek explicit authority under Article 49 of the Law to delegate to market surveillance personnel conducting investigations the authority to obtain documents from any person believed to have information about possible violations of securities laws, regulations or rules. Penalties should be imposed for failure to comply with a request or for falsifying records requested in the course of an investigation.
3. The CMA should require companies licensed under the Law to keep records and make them available to market surveillance and other CMA staff upon request.
4. The CMA should require individuals licensed under the Law or associated with companies so licensed to answer questions posed by market surveillance and other CMA staff.
5. Ascertain that the procedures for adjudicating market surveillance cases under the Capital Market Law include provisions for reasonable notice to persons charged with violations, for fair hearings before sanctions are imposed, and for appeal.
6. Penalty guidelines should be developed to assist the CMA Board in determining appropriate sanctions for all manner of violations, within the confines of the Law.
7. Use seminars or other strategies to improve voluntary compliance and increase understanding of the Law and regulations regarding market manipulation, fraud, and insider trading, targeting the following groups:
 - ❑ Public companies – to understand their responsibilities to safeguard inside information and to fully disclose material information
 - ❑ Employees of public companies – to understand their fiduciary duty to safeguard inside information of their company
 - ❑ Market participants – to understand what is prohibited behavior

- Members of the public – to understand what is prohibited behavior and how to avoid being the victim of a fraud.
8. As much information as possible about enforcement actions should be made public. This information further educates market participants about what behavior CMA believes violates the Law and highlights the presence of an effective and vigilant market surveillance program.

J. Legal and Regulatory Structure

□ Assessment

The present Capital Market Law has many of the necessary provisions to prohibit insider trading and market manipulation.

Insider trading is prohibited under Article 64 of the Law which provides for imprisonment and fines for “any person who...has benefited, he, his spouse and his children from insider information of his work...”. This appears to be applicable to the classic misuse of inside information by a corporate officer or director and could cover the actions of someone who “tips” another person about inside information. But it doesn’t cover the actions of a “tippee” who takes advantage of the inside information received from the insider. It also does not seem to apply to a situation where a person misappropriates information that is not related to his employment relationship. Where the U.S. law requires the benefit from the use of the inside information to occur “in connection with the purchase or sale of a “security”, no such qualifier appears in the Egyptian law. This is clearly advantageous to enforcing the Egyptian prohibition against insider trading.

Market manipulation is prohibited under Article 63 of the Law which provides for imprisonment and fines for “any person quoting artificial price of a security, or conducting a false transaction, or attempting by fraud to affect market prices.” This provision would appear to have a fairly broad application.

In terms of remedies, under Article 21 of the Law, the Chairman of CASE may suspend bids and offers aiming at price manipulation, may cancel unlawful transactions, and may suspend trading in a security. The Chairman of the CMA can also take these same actions.

Under Article 30 of the Law, the Chairman of the CMA can suspend the activities of a licensed company for up to 30 days and specify remedial measures to be taken by the company during that period. If the company does not remove the causes for the suspension during the suspension period, the Chairman may submit the case to the CMA’s Board of Directors for revocation of the company’s license. Under this provision, the remedial measures can only relate to rectifying the situation which caused the suspension in the first place. The action carries no additional penalty for having violated the rule. Take for example a situation where a broker/dealer has made unauthorized transactions in a customer’s account. The suspension under Article 30 and the remedial measures to be taken would require the broker/dealer to restore the funds to the customer’s account but *would not* impose any additional sanctions on the firm. If, in this particular example, the broker/dealer refused to restore the funds to the customer’s account, the only remedy available to the Chairman of the CMA is to recommend the revocation of the broker/dealer’s license – a very harsh penalty.

Article 31 of the law allows the CMA Board of Directors to take disciplinary action and impose remedial sanctions on a company, including censuring the company and placing limitations on some or all of the company’s activities. The Board may also require the company’s board to investigate the violations and take appropriate measures, to appoint an observer on the

company's board of directors, and to dissolve the company's board of directors. There are no provisions under either Article 30 or Article 31 for fines.

Articles 63 through 69 of the Law provide for criminal penalties. The maximum penalty is imprisonment for up to five years and a fine of up to LE100,000 for certain specified violations, and a fine of LE2,000 for other violations. When it is the company that commits the violation, the responsible manager may also be subject to the same sanction as the company. Both the company and the manager may be banned from their profession or prohibited from conducting the business in which the violation occurred for up to three years.

There appears to be no authority for the CMA to impose administrative sanctions against individuals who work for, control, or are otherwise associated with companies licensed by CMA. Under Article 89 of the Executive Regulations, the CMA can take action against individuals who represent their brokerage firm on the CASE. However, if an employee of the brokerage firm other than the floor broker is responsible for the wrong doing, the CMA has no authority to sanction him. In addition, the CMA may require a company to take action against a current employee as one of the remedies under Articles 30 and 31 of the Law.

With regard to CASE, Presidential Decree No. 51 requires CASE to refer violations of laws, regulations, and rules to the CMA for action. This appears to restrict CASE's ability to take actions against its own members.

At the present time, because its remedies are somewhat limited, both CASE and CMA resort to canceling trades as the quickest and surest method of addressing abuses. While both CMA and CASE should be commended for having the courage to act (this is not always the case in emerging markets where there is little experience with enforcement), canceling trades can create market uncertainty. Other remedies are less intrusive and therefore more effective.

□ Recommendations

1. Amend Article 30 of the Law to provide for penalties to be assessed for the violation that led to the action. Penalties could include fines or other disciplinary measures such as requiring the company to install certain written supervisory procedures.
2. Amend Article 31 of the Law to provide for a broader list of penalties and sanctions such as fines or obtaining monetary relief from the violator.
3. Clarify the authority of CASE to take action against its members, including fines, administrative actions, suspensions, and removal from membership in the exchange.
4. Empower CMA to take administrative action against and impose sanctions on individuals who work for, control or are otherwise associated with companies licensed by CMA.
5. Adopt a rule that provides a clearer definition of insider trading than what is covered in Article 64 of the Law. The language of the rule should clarify that insider trading means the purchase or sale of securities by any person, directly or indirectly, while in possession of material nonpublic information, in violation of a duty owed to the issuer, the issuer's shareholders, or the source of the information. Material information should be defined to include any information that could affect the value of the securities.
6. Proving a manipulation is quite difficult, even in the U.S. where the law is quite clear about what constitutes manipulation. It would assist CMA in proving a case of price manipulation if the following language were included in the Law:

"It shall be unlawful for any person, directly or indirectly, to create a false or misleading appearance of active trading in a security or a false or misleading appearance with respect to the market for a security, or to: (1) effect a transaction in such security that involves no

change in actual ownership; or (2) enter an order for the purchase or sale of such security with the knowledge that an order of substantially the same size, at substantially the same price and time, for the purchase or sale of such security will be entered by such person or others acting in concert with such person.

“It shall be unlawful for any person or persons, directly or indirectly, to effect one or more transactions in a security that (1) raises its price for the purpose of inducing the purchase of the same security or another security of the same issuer by others, (2) depresses the price for the purpose of inducing the sale of the same security or another security of the same issuer by others, or (3) creates trading, actual or apparent, for the purpose of inducing a purchase or sale by others.”

7. In order to ensure that securities transactions that take place off CASE, such as those involving mergers and tender offers, are covered by the fraud provisions of the Law, a general anti-fraud provision should be included in the Law as follows:

“It shall be unlawful for any person, directly or indirectly:

- a) To employ any device, scheme or artifice to defraud,
 - b) To knowingly or recklessly
 - (1) Make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
 - (2) Engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security, the rendering of investment advice, any authorization, consent, proxy or other information solicited from security holders or published in connection with a meeting or other action taken by security holders, and any tender offer for securities or any solicitation of holders of securities in favor of or in opposition to any such tender offer.”
8. The CMA should vigorously enforce the requirement under Article 87 of the Executive Regulations that listed companies report shareholdings of certain parties, including board members and 10 percent holders. This provision should be amended, however, to require the company to report only the holdings of officers and key employees rather than all employees.

K. Implementation Plan

The following Implementation Plan organizes the recommendations set forth in the preceding sections on organization/structure, staffing, resources, training, procedures and checklists, automation, technology, enforcement, and legal and regulatory structure into four phases, with the recommendations requiring immediate action appearing in Phases One and Two. Equally important, but not included in the Implementation Plan, are recommendations for amendments to the Capital Market Law.

The page number in the report where the recommendation is discussed is referenced and the entity responsible for implementing the recommendation is noted. In some cases, there is more than one entity involved. For example, the notation (Page 10, CMA/CMD) indicates that the recommendation is discussed on page 10 of the report and that CMA and the Capital Markets Development (CMD) project are both responsible for implementing the recommendation.

Phase One

(November – December 2000) – Initial steps in implementation.

- ❑ Hold a joint workshop on the Report recommendations and implementation plan for CMA and CASE.
- ❑ Plan agendas and materials for training courses.
- ❑ Draft initial procedures manual.
- ❑ Finalize requirements and immediately begin the programming necessary to complete all three phases of development of the CASE stock watch system. (Page 8, CASE)

Phase Two

(January–March 2001) – Training of CMA and CASE staff, introduction of written procedures, and enhancement of systems and facilities.

- ❑ Present a Cairo-based training course in market surveillance for all CMA and CASE analysts and attorneys. CMA oversight staff should also attend this training. (Page 12, CMD)
- ❑ Finalize the detailed procedures manual covering all aspects of the on-line and off-line investigation process as well as important administrative procedures for use by both CMA and CASE analysts. (Page 14, CMD)
- ❑ Procure additional PCs so that each analyst in market surveillance has a PC procured by the Project. (Page 11, CMD)
- ❑ Provide access to classes in English for all analysts who must be more fluent in English in order to pass the USAID English exam. (Page 13, CMA/CASE)
- ❑ Provide follow-up training on a one-on-one basis to reinforce the earlier classroom training in market surveillance. (Page 12, CMD)
- ❑ Commence retaining information in the CMA database on all orders, from the time they are entered until they are modified, cancelled or filled. (Page 15, CMA)
- ❑ Provide market surveillance analysts access to Reuters and the Internet via a terminal located within the department. (Page 11, CMA)

- ❑ Begin publishing as much information as possible about enforcement actions in order to enhance the deterrent effects of the market surveillance program. (Page 20, CMA/CASE)
- ❑ Install a FAX machine in market surveillance's new space and require FAX or hand delivery of documents requested from broker/dealers and companies in connection with investigations. (Page 11, CMA)
- ❑ Design procedures and mechanisms for recording actions taken by CASE on each alert generated by the on-line stock watch system and for tracking a review or investigation from the time it is initiated until it is closed, disciplinary action is taken or the matter is referred to CMA. (Page 14, CASE/CMA/CMD)

Phase Three

(April–June 2001) – Division of responsibilities for market surveillance between CMA and CASE, continued skill building, and further enhancement of procedures and resources.

- ❑ Delegate to CASE the responsibility to carry out on-line surveillance. (Page 8, CMA/CMD)
- ❑ Discontinue on-line surveillance at CMA. (Page 16, CMA)
- ❑ Determine with CASE how CMA will be kept informed of CASE inquiries and how and when matters will be referred from CASE to CMA for further investigation. (Page 8, CMA/CASE)
- ❑ Send CMA and CASE analysts to CMD-sponsored overseas training "Surveillance Practices in Stock Exchanges". (Page 11, CMD)
- ❑ Provide CMA analysts with secure access to customer names in connection with investigations. (Page 8, CMA)
- ❑ Train CMA and CASE staff responsible for on-site inspections in gathering evidence to support market surveillance investigations. (Pages 10/12, CMD)
- ❑ Allow analysts to contact and question brokers, customers and listed companies in connection with an investigation without first obtaining permission from a supervisor. (Page 13, CMA)
- ❑ Send analysts from both CMA and CASE to the U.S. SEC Institute for Securities Market Development in April. (Page 12, CMD)
- ❑ Coordinate with CASE before initiating an investigation which has not resulted from a referral from CASE. This will help eliminate duplication of effort. (Page 8, CMA)
- ❑ Develop a process for assigning new off-line investigations to analysts, taking into consideration workload. (CMA/CMD)
- ❑ Develop a mechanism at CMA for tracking the current status and final disposition of each investigation from the time it is assigned to an analyst until it is closed or referred to the Legal Department for disciplinary action or prosecution. (Page 13, CMA/CMD)
- ❑ Formalize procedures for transferring an investigation to the Legal Department once it reaches the point where it is necessary to interview witnesses. (Page 19, CMA/CMD)
- ❑ Review the procedures for adjudicating market surveillance cases to ascertain whether they include provisions for reasonable notice to persons charged with violations, for fair hearings before sanctions are imposed, and for appeal. (Page 19, CMD)

- ❑ Provide each analyst with a full feature telephone for making calls outside the CMA in connection with investigations. (Page 10, CMA)
- ❑ Subscribe to periodicals and industry publications to enable the analysts to stay informed of events that could affect the market in CASE-listed stocks. (Page 11, CMA)
- ❑ Provide analysts with nearby access to a photocopier so that “working copies” of original documents can be made for use during an investigation. Convenient access to a shredder should also be provided. (Page 11, CMA)
- ❑ Assign the daily responsibility for reading newspapers and scanning Reuters for pertinent news articles to one analyst, either on a permanent or rotating basis, who would summarize the information for the other analysts. (Page 14, CMA)
- ❑ Train analysts in Microsoft Word and encourage them to compose their investigation reports on their PCs. (Page 13, CMD)
- ❑ Ascertain that the procedures for adjudicating market surveillance cases under the Capital Market Law include provisions for reasonable notice to persons charged with violations, for fair hearings before sanctions are imposed, and for appeal. (Page 19, CMA/CMD)
- ❑ Use seminars or other public awareness strategies to improve voluntary compliance and increase understanding of the Law and regulations regarding market manipulation, fraud, and insider trading, targeting the following groups:
 - ❑ Public companies – to understand their responsibilities to safeguard inside information and to fully disclose material information
 - ❑ Employees of public companies – to understand their fiduciary duty to safeguard inside information of their company
 - ❑ Market participants – to understand what is prohibited behavior
 - ❑ Members of the public – to understand what is prohibited behavior and how to avoid being the victim of a fraud.

Phase Four

(July–August 2001) – Initial CMA oversight exam of CASE and strengthening of enforcement.

- ❑ Conduct an evaluation of the fully implemented CASE stock watch system to determine whether it provides all of the functionality required to support an effective market surveillance program. (Pages 15/16, CMA/CMD)
- ❑ Conduct an oversight exam of the CASE market surveillance program, focusing on whether the CASE stock watch system identifies all unusual market activity, whether initial inquiries are opened when appropriate, whether CASE follows its written procedures, that CASE properly documents its reviews and investigations, that it follows the agreed-upon procedure for referrals to CMA, and that the penalties levied against members are appropriate. A CMD short-term consultant will participate in this first oversight review. (Pages 15/16, CMA/CMD)
- ❑ Establish a market surveillance library for manuals, training materials, newspapers and periodicals, memoranda and other documents such as case reports, for reference and training purposes. (Page 11, CMA/CMD)
- ❑ Send analysts from both CMA and CASE to the U.S. SEC Institute on Securities Enforcement and Oversight in November. (Page 12, CMD)

- ❑ Assemble a manual of reference materials to complement the procedures manual and to provide additional support to investigations. (Page 14, CMD)
- ❑ Develop guidelines to assist the CMA Board in determining appropriate sanctions for all violations, within the confines of the Law. (Page 19, CMA/CMD)
- ❑ Adopt a rule that provides a clearer definition of insider trading than what is covered in Article 64 of the Law. (Page 20, CMA)
- ❑ Vigorously enforce the requirement under Article 87 of the Executive Regulations that listed companies report shareholdings of certain parties, including board members and 10 percent holders. (Page 22, CMA)

Conclusion

CMA and CASE have taken initial steps to lay the foundation for a Market Surveillance Program for the Egyptian market. Both organizations recognize the importance of an effective market surveillance and enforcement program in building confidence in the Egyptian capital markets and in attracting and retaining foreign investment.

Both organizations have staffed their programs with competent and motivated staff, have invested considerable resources in developing computer software programs to support surveillance, and have begun to discipline individuals and companies that have been found to violate the rules. In order to build on this foundation, CMA and CASE must recognize that market surveillance is a joint endeavor. By combining resources and working together, they can establish an effective surveillance and enforcement presence.

The four most critical actions that must be taken to achieve this goal are: 1) sharing responsibility for surveillance with CASE conducting on-line reviews and CMA carrying out off-line investigations; 2) enhancing the CASE stock watch system to provide alerts of unusual market activity; 3) thorough training of market surveillance and enforcement analysts and attorneys of both organizations; and 4) reliance by both organizations upon common written procedures for conducting inquiries and investigations.

These actions, coupled with legal reforms that provide CMA and CASE with additional enforcement remedies, will create an effective market surveillance and enforcement program that will enhance the credibility of the Egyptian capital markets and protect both foreign and domestic investors.

APPENDICES

- A. Meetings in Cairo
- B. Assessment of Market Surveillance Program at CASE
- C. Survey of Surveillance Software Providers
- D. Table of Contents (Investigation Reference Manual)
- E. Sample Agenda for Market Surveillance Training
- F. Recommendations for Amendments to the Capital Market Law

APPENDIX A

The following meetings were held with officials of the Capital Market Authority and the Cairo and Alexandria Stock Exchange in order to assess their Market Surveillance and Enforcement Program.

CMA Meetings

9/12/00	Ashraf Shamseldin, Deputy Chairman
9/12/00	Ahmed A. Kheireldin, Under Secretary for Market Surveillance
9/12/00	(an IT market surveillance. Analyst)
9/13/00	Shady Aboubakr, Market Surveillance Analyst
9/17/00	Abdel Hamid Ibrahim, Chairman
9/18/00	Shady Aboubakr, Market Surveillance Analyst
9/18/00	Ahmed A. Kheireldin, Under Secretary for Market Surveillance

CASE Meetings

9/11/00	Ahmed Abou El-Saad, Manager of Market Surveillance
9/20/00	Ahmed Abou El-Saad, Manager of Market Surveillance
9/20/00	Ahmed Aly Khedr, Director of Market Surveillance and Market Control
9/20/00	Ahmed Abou El-Saad, Manager of Market Surveillance (presentation on new trading system)

APPENDIX B

Assessment of the Market Surveillance Program at Case

The Scope of Work called for an evaluation of the current state of market surveillance and enforcement in the Egyptian market. Since the market surveillance function is presently carried out independently by the CMA and CASE, it was necessary to evaluate each program separately. The body of this report covers the evaluation of the market surveillance program at the CMA. The results of the evaluation of the CASE market surveillance program are covered in this Appendix.

Organization/Structure

The CASE Market Surveillance Department and the Market Control Department, which oversees all activity on the floor of the Exchange, have the same Director and work together cooperatively. Market Control alerts Market Surveillance to rumors on the floor and supports Market Surveillance inquiries by gathering information from brokers. Market Control makes decisions similar to those of a Floor Governor at a U.S. stock exchange, including trade cancellations, managing the Exchange error account, and implementing trading halts. The close proximity of the Market Control Department staff and the “market intelligence” they provide enhances the Market Surveillance analysts’ ability to police the market on a real-time basis.

The present duplication of effort between CASE and CMA should disappear with the delegation of responsibility for on-line surveillance to CASE, as recommended. However, close coordination will continue to be necessary between the two programs because preliminary reviews that indicate potential violations will be transferred by CASE to CMA or will be jointly investigated by the two organizations.

Staffing

There are five or six Market Surveillance analysts. Several of them, including the Manager of the Program, were formerly securities traders on the floor of CASE and some have previous experience in the Market Control Department. Some are reasonably fluent in English and the rest are enrolled in English classes.

The Director of the Department considers English “a must” because, in his opinion, the U.S. markets are the best model. He has visited other developed markets and believes U.S. regulation represents best practice. As a result, he wants his staff to have fluency in English so that they can travel to the U.S. for training. He purposely hired former traders to be analysts because he thinks experience on the floor is the best pre-requisite for a surveillance analyst.

Many of the analysts have been to the U.S. for internships, conferences and visits to securities exchanges. At least one has attended a U.S. SEC Institute.

Resources

The market surveillance program is located in newly renovated space in the old stock exchange building. It has a security lock on the door to the space to prevent unauthorized access but the lock does not appear to be activated. Although the location of the Department is sufficiently isolated, it is a disadvantage that the Director’s office can only be reached by passing through the department. This may explain why the security lock is not in use.

The office is equipped with seven PCs, all of which appear to be relatively new, two printers, a FAX, the Reuters newswire, the broker/dealer hotline, and many telephones. Quite a few of the cabinets in the room have locks for protecting sensitive documents.

The analysts have ready access to customer complaints, and are routinely consulted when a complaint affects a stock or a particular broker.

Analysts must request permission from the Chairman of the Exchange to get the identity of customers from the Information Technology Department in connection with an inquiry; however, the Chairman has never denied such a request.

Training

As indicated earlier, many of the analysts and their supervisor have had the opportunity to travel overseas for visits to exchanges, attend conferences, or for training. These trips have undoubtedly broadened their understanding of the purpose of market surveillance and, hopefully, given them additional knowledge for conducting inquiries into unusual trading activity.

The department was established less than one year ago which means that all of the analysts are new in their positions. Even though many have had overseas training, they need a Cairo-based training course in on-line surveillance. In addition, as recommended in under Training in the body of this report, CASE analysts, along with their CMA counterparts, should attend a basic course in conducting off-line inquiries and investigations. CMA and CASE analysts must work together to create an effective market surveillance presence overall. The coordination and cooperation necessary to meet this objective will be achieved much quicker if they are trained together.

Additional overseas visits and training, following the Cairo-based training would build on the analysts' skills and abilities.

Procedures and Checklists

There are no written procedures governing reviews and investigations. Written procedures are essential to ensure consistency in approach across all analysts and to provide for close coordination with CMA on referrals. In addition, a case tracking mechanism is necessary to document reviews, both for CASE management and for CMA oversight of the CASE market surveillance program.

Automation

The requirements for the CASE surveillance system were written by two Oracle business consultants with experience at NASDAQ and a large U.S.-based broker/dealer. Phase I of the system which is being used by the analysts today provides a stock watch alert capability as well as analytical tools for reviewing current and historical orders and transactions.

An alert is generated if a stock trades up or down in price more than an established parameter, if the size of the order or trade is greater than an established parameter, or if the LE value of the order or trade exceeds a certain parameter. The parameters can be set by sector, separately for orders and trades. The system generates about 1,000 alerts each trading day.

In addition to the stock-watch alerts, the system provides a database of order and trade information which the analysts use to research activity on a particular stock, a sector, or the

market as a whole for the current trading day, or for trading activity going back to September 1999.

In addition to the fact that the alerts system is not completely tested and has some “bugs” which need to be resolved, it has weaknesses which are expected to be addressed in the further implementation of Phase I or in Phase II and III enhancements to the system.

The present set of parameters are sector-based rather than stock-based. Since stocks have distinctly different individual price and volume trading patterns, even though they may be in the same sector, sector-based parameters are not useful. Secondly, the present alerts do not take into consideration historical trading activity and therefore do not recognize unusual activity that takes place over more than a single trading day, for example over a week or a month.

When the stock-watch system is fully operational, whether through completion of Phase I or enhancements planned for Phase II and III, it will have historical price and volume parameters for each stock, as well as parameters based on individual customers’ historical net trading activity, transactions by insiders, imbalance of orders, brokerage firms’ daily clearing balances, and trades by brokerage firm principals.

With the addition of these refinements to the overall system – which includes the stock watch alerts and the database of current and historical data – CASE will have a comprehensive tool for performing on-line surveillance of its market.

Because the system of alerts at present is not sufficient, CASE should be required to move quickly to implement the remaining features of the full-blown system.

Technology

CASE has defined the requirements for and begun implementing its own customized market surveillance system.

Enforcement

CASE appears to have few remedies for addressing abuses it uncovers in the course of its reviews and investigations. Most of its actions to date have involved cancellation of trades prior to settlement date. As noted in the body of this report, cancellation of trades causes uncertainty in the market and should be avoided if possible.

CASE needs to adopt membership rules which define improper activity so that once they have the authority they can discipline members who violate the rules.

Legal and Regulatory Structure

There should be no legal requirement that CASE be designated an SRO in order to assume responsibility for on-line surveillance of its market. They should be given the responsibility for real-time surveillance of CASE-listed securities as soon as possible, with active oversight by CMA.

As noted in the body of this report, CASE’s jurisdiction over its members and ability to take disciplinary action against them for improper conduct appears to have been altered by Presidential Decree No. 51. This must be rectified so that CASE can impose a full range of sanctions against its members. These actions will give CASE an effective and visible market surveillance presence and build confidence in the Egyptian market.

APPENDIX C

Annotated Table Of Contents

1. *Primer: Investigating and Proving a Market Manipulation Case*

This 1993 document prepared by a member of the U.S. SEC Enforcement staff is a comprehensive discussion of different types of manipulative schemes and what evidence is necessary to prove them. While all of the examples cited are derived from U.S. case law, the discussion of “what to look for” can be applied in any jurisdictions. Detailed list of U.S. cases involving manipulations at the end of the document.

2. *An Overview of Market Manipulation: Legal and Practical Aspects*

Another excellent outline of the basic requirements to prove a manipulation under U.S. Law with a very good outline of the elements of common manipulative schemes beginning on page 11. Contains a brief description of key U.S. cases involving manipulations beginning on page 28.

3. *Investigating and Prosecuting Market Manipulation*

Prepared by leading stock exchanges for members of the International Organization of Securities Commissions, this document discusses the issues involved in investigating and prosecuting market manipulation cases from a more general – and - international point of view.

4. *Testimony Guidelines*

Detailed guidelines for investigatory staff prepared by the Market Surveillance Department of the National Association of Securities Dealers. It contains suggestions on preparations for questioning a witness and suggests questions to cover in the testimony. It also contains suggested responses to objections raised by the witness.

5. *Testimony Procedures and Techniques*

Brief outline of suggested techniques for taking testimony prepared by the U.S. SEC Division of Enforcement.

6. *Report of Investigation Concerning Ronald F. Beck's Trading in American Capacity Group, Inc. Common Stock*

This document details the findings from an insider trading investigation conducted by the Market Surveillance staff of the National Association of Securities Dealers. It is an excellent example of an investigation memorandum. It covers all of the pertinent facts uncovered during the investigation, it describes in detail why the activity violated certain rules, and it contains detailed exhibits which document all of the findings.

7. *Report of Investigation Concerning the Manipulation of Dynamic American Corporation Common Stock by Richard Gross and Vincent Paolano*

This document details the findings of an investigation into an alleged manipulation of a Nasdaq stock. This document illustrates the facts that must be documented during the investigation into a manipulation and the level of detail that must be covered in a memorandum which recommends disciplinary action.

8. *SEC Enforcement and the Internet: Meeting the Challenge of the Next Millennium*

This article which appeared in the publication The Business Lawyer in May, 1997 was written by the two staff persons at the U.S. SEC who direct the Market Surveillance program and the Internet Surveillance program. It describes the kinds of illegal activities that the SEC has uncovered in policing the Internet and summarizes briefly some of the key disciplinary actions that have resulted.

APPENDIX D

Sample Agenda for Market Surveillance Training

Course Objective: To gain an understanding of the techniques necessary to successfully pursue inquiries, conduct investigations and prosecute cases involving potential violations of insider trading, manipulations and other fraudulent transactions.

Course Length: Two weeks

- I. Investigating Insider Trading
 - A. What is insider trading?
 - B. What is considered “material” information?
 - C. Who is an “insider”?
 - D. Establishing materiality.
 - E. Requesting a chronology of events from the company.
 1. Questions to ask.
 2. Documents to request.
 - F. Next steps.
 1. Identify time period.
 2. Obtain broker/dealer trading records, identify suspect account activity, and obtain account documents.
 3. Research relationships.
 4. Conduct interviews.
 5. Take testimony.
 6. Prosecute.
 - G. Suggested background reading.
 - H. Discussion of significant case law.
 - I. Case studies.
 1. Identify the news and date. Is the news material? If so, explain why.
 2. Identify the insider.
 3. Prepare a chronology of the significant events.
 4. Did the insider have knowledge of the confidential information?
 5. Review the trading data, including when the account was opened, the type of account, who was the beneficial owner of the account, and what was unusual about the account.
 6. Prepare a chronology of events relating to the trading activity as it relates to the corporate chronology.
 7. What will be the defense of the insider?

8. What is the necessary evidence: chronology, account documents, insider's motive?

II. Investigating Manipulation

A. What is manipulation?

1. Intentional interference with the free forces of supply and demand.
2. Conduct designed to deceive or defraud by controlling or artificially affecting securities prices and/or volume.
3. Economically irrational trading such as "wash sales" and "matched orders".
4. Definitions.

B. Elements of a market manipulation.

1. Series of transactions.
2. Manipulative effect.
 - a. Create actual or apparent value.
 - b. Raise or depress the price of the stock.
3. Manipulative purpose.
 - a. Motive (usually money).
 - b. Course of business that operates as a fraud or deceit.

C. Proof of manipulation.

1. Based on inferences drawn from circumstantial evidence (significant amount of factual detail).
2. Collapse of market when the manipulator ceases activity.
3. Evidence of a series of transactions coupled with a motive to manipulate (inferred from the person's pattern of trading).
4. The manipulator caused actual or apparent activity or a rise in market price.

D. Characteristics of manipulations.

1. Trading.
 - a. By family, friends, and associates.
 - b. In discretionary and controlled accounts.
 - c. Circular flow of shares.
 - d. Ghosting of orders.
 - e. Wash sales.
 - f. Matched orders.

2. Prices.
 - a. Price setting or leadership.
 - b. Erratic pricing.
3. Creation of demand.
 - a. By issuer - corporate events or news.
 - b. By brokers - research analysis, recommendations, discretionary account transactions.
4. Motive.
 - a. To make trading profits or commissions.
 - b. To raise value of collateral.
 - c. To dress up the market for a secondary offering or other financing.
 - d. To meet initial or maintenance listing requirements.
 - e. To sell insider stock.
 - f. Personal reasons such as pride, status, prestige, public attention.
5. Schemes.
 - a. Blind pools, blank checks, reverse acquisitions, ponzi schemes.
 - b. Box jobs, domination and control.
 - c. Misrepresentations, false or misleading information, omissions of material facts.
6. Players.
 - a. Finders and promoters.
 - b. Brokers.
 - c. Purchasers and sellers.
 - d. Transfer agents.
 - e. Issuer, its owners, officers, lawyers, accountants, underwriters, etc.

E. Hallmarks of a classic manipulation.

1. Up-ticking and purchasing at increasing prices despite being long the stock.
2. Up-ticking the firm's already high bid without executing a trade.
3. Executing many transactions away from the inside bid and offer.
4. Soaking up the floating supply to gain control of the market for the stock.

5. Dominating and controlling the market.
6. Significant trading profits (consistent profits without losses).
7. High commissions (as a percentage of the net amount of the transaction – especially if it is a pattern).
8. Brokers traded at a loss, but certain retail or institutional accounts profited.
9. Prearranged block trading, wash sales, matched orders, circular trading and ghosting of orders.
10. Patterns of trading that don't look right or make any economic sense.

- F. Suggested background reading.
- G. Discussion of significant case law.
- H. Case studies.

III. Interview Skills and Taking Testimony

- A. Definition of an interview: a structured question and answer session designed to elicit specific information.
- B. Characteristics of good interviews.
- C. Characteristics of a good interviewer.
- D. The witness' rights.
- E. The interrogation.
 1. Background questions.
 - a. Residential addresses.
 - b. Home and work telephone numbers.
 - c. Educational background.
 - d. Family members, spouse (maiden name).
 - e. Tax or other identification numbers.
 - f. Bank accounts and numbers.
 - g. Financial problems.
 - h. Previous testimony – subject or defendant in other proceeding?
 3. Employment questions.
 - a. Dates and places.
 - b. Title and positions.
 - c. Organizational/authority chart.
 - d. Day-to-day function and responsibilities.
 - e. Supervisory responsibilities/procedures.

- f. Supervisory chain.
 - g. Co-workers, assistants, secretaries.
 - h. Compensation.
- 4. Books and records and other documents to review.
 - a. Securities ledger.
 - b. Stock position.
 - c. Customer ledger.
 - d. Order slips.
 - e. Confirmations.
 - f. News and corporate events.
 - g. Broker's files required to be maintained.
 - h. Research/recommendation reports.
 - i. Chronology of events.
 - j. Corporate filings (prospectus, annual report, proxy).
 - k. Telephone records.
 - l. Payments – receipt, check, wire instructions.
 - m. Signed stock certificate.
 - n. Written correspondence.
- 5. Trading activity questions.
 - a. Ever traded _____stock before?
 - b. Personal background.
 - c. Why did you buy/sell the stock?
 - d. Who was the broker/trader?
 - e. Was the order solicited?
 - f. Names of relatives.
 - g. Names on the chronology.
 - h. Trading/investment strategy.
 - i. Timing of trades and decisions to buy or sell.
 - j. Method of payment.
- 6. Mock testimony exercise.
 - a. Be prepared. Have thorough knowledge of the facts and documents.
 - b. Focus. Ask pertinent questions. Have an outline of questions you want to ask.

- c. Proper coordination by the interviewing team.
- d. Start in and try to stay in chronological order. Use previously prepared chronology of events and ask questions to fill in the gaps.
- e. Keep to a line of questioning until the matter is exhausted, especially when questioning about trading activity.
- f. Keep asking follow-up questions: who, what, when, where, how and why?
- g. Use documents chronologically and/or by subject matter to facilitate questioning.
- h. Ask the witness to identify, if possible, persons on your list of suspect accounts.

7. Class discussion of mock testimony.

IV. Case Organization and Document/File Maintenance

A. Internal documents.

- 1. Trading data, news, public filings, etc.
- 2. Analyses, notations, memoranda, etc.
- 3. Request letters and other correspondence.

B. External documents.

- 1. Receipt of documents.
 - a. Record of when, how and from whom.
 - b. Original copies (record on document index and do not mark on original documents – keep them “clean” as evidence).
 - c. Make “working” copies.
 - d. Keep external files free of notations and work products.

C. Organization.

- 1. Files by source.
- 2. Files by subject.
- 3. Folders with headings.

D. Document index.

- 1. Description and number of pages.
- 2. Date received.
- 3. Source (from whom, where, why, how).

E. Example of a large case file.